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Specialists in Strategic, Enterprise and Project Risk Management

RISK MANAGEMENT AND CORPORATE GOVERNANCE

Dr Dale F Cooper

Introduction

This paper contains the presentation material from an after-dinner talk on 'Risk Management and Corporate Governance' to the Risk Engineering Society in Sydney on 19 July 1999, with additional reference citations.

Presentation

Risk Engineering Society
Sydney, 19 July 1999

**RISK MANAGEMENT
and
CORPORATE GOVERNANCE**

Dr DALE F. COOPER
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EXAMPLES

Hammersmith & Fulham, 1986	0.9 bn USD	IR swaps
Orange County, 1994	1.7 bn	IR derivatives
Barings, 1995	1.4 bn	Derivatives
MGAM, 1996	0.71 bn	Unauthorised investments
Sumitomo, 1997	3.0 bn	Copper forwards
NatWest, 1997	0.14 bn	Mispricing

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WHAT IS CORPORATE GOVERNANCE?

- Corporate governance generally refers to the processes by which organisations are directed, controlled & held to account
- It encompasses authority, accountability, stewardship, leadership, direction & control exercised in the organisation

Source: ANAO Principles & Better Practices Discussion Paper
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WHY MUST I EAT MY VEGETABLES ?

- If not, your hair & teeth will fall out !
- They are good for you !
- **They will help you to see in the dark !**

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TRENDS IN CORPORATE GOVERNANCE

- Moving from **conformance** ...
 - Focus on compliance, controls, minimum standards & responsibilities
- Moving towards **performance** ...
 - Focus on best practice, improved corporate outcomes & value creation

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ROLE OF THE BOARD (Hilmer)

- Ensure corporate management is continuously striving for above-average performance, taking account of risk and without defrauding or misleading shareholders & other stakeholders

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CLERP, Proposal Paper 3

- Public corporations need to demonstrate to investors that their governance structures are appropriate to ensure that the return to investors on their capital will be maximised

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CORPORATE GOVERNANCE (Barrett)

- Corporate governance is basically concerned with structures & processes for decision-making and with the controls & behaviour that support effective accountability for performance outcomes
- Major elements are business planning, risk management, performance monitoring & accountability

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ROLES OF THE BOARD (Garratt, Tricker)

	Conformance	Performance
External	Accountability	Policy formulation
Internal	Supervising management	Strategic thinking
	Short-term	Long-term

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REASONS FOR POOR BOARD PERFORMANCE

- Unclear roles & responsibilities
 - Conformance vs performance
- Performance often not central
 - Conformance seen as ‘must do’
- Weak director selection processes

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RISK MANAGEMENT

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RISK

- Risk is exposure to the consequences of uncertainty
- Risk has several aspects:
 - Likelihood
 - Consequences
 - Controls
- Risks & opportunities

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BENEFITS OF RISK MANAGEMENT

- Better understanding of uncertainty
- Better design & planning to prevent or avoid risks and exploit opportunities
- Better contingency planning & response selection to reduce negative impacts and capture potential benefits
- Better decisions, leading to . . .
- **Better & more assured outcomes**

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THE RISK MANAGEMENT PROCESS, AS/NZS 4360:1999

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RISK MANAGEMENT & CORPORATE GOVERNANCE

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THE LEARNING BOARD (Garratt)

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ESTABLISH THE CONTEXT

- Strategic purpose
 - Vision, mission, goals, objectives
- Stakeholders
- Targets for performance
 - Indicators, standards & criteria
- Questions
 - What might go wrong?
 - How can we do better?

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RISK IDENTIFICATION

- Environmental scanning
- SWOT
- Vulnerability analysis
- Trends & warning signals
 - Monitoring & review processes

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BOARD TASK: SET CRITERIA & MONITOR PERFORMANCE

- Define what is meant by sustainable, above-average performance
- Monitor performance against the specified criteria

– Source: Hilmer

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COMPLIANCE, CONFORMANCE

- Protection for the organisation, the Board as a whole, & the directors
- Focus on
 - what might go wrong (risks, rather than opportunities)
 - controls
 - audit processes

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CONFORMANCE ACTIVITIES PROMPTED BY REGULATION (1)

- Hazardous materials & production
 - occupational health & safety
 - public health & safety
 - environmental protection
- Examples:
 - Mines, petrochemicals, offshore

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CONFORMANCE ACTIVITIES PROMPTED BY REGULATION (2)

- Financial markets & dealings
 - investor protection
 - market confidence
 - systemic stability
- Examples:
 - Securities, futures, prospectuses

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THE AREAS OF COMPLIANCE RISK ARE EXPANDING

- Corporations Law, common law
 - prospectuses, insolvent trading
- Taxation, new tax regimes
- Trade practices, OH&S, environment, equal opportunity ...

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DERIVATIVES DISASTERS & BOARD RESPONSES

- Well-publicised major losses
 - Responses not always appropriate
- Ban all hedging !
- Litigate !
- Improve systems, processes & controls

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CONTROLS

- Management systems & procedures
 - Human systems, training & culture
 - Physical controls & barriers
 - Commercial & legal controls
- ... but they may not all work well !

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ACTUAL & INHERENT RISKS

- Actual risk
 - based on likelihoods & impacts, with the current controls in place
- Inherent risk
 - how bad might it be if there were a credible failure of controls ?

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CONTROL SYSTEMS & PROCEDURES

- Audit & assurance processes
 - Audit & Compliance Committee
 - Internal & external audits
 - Control self-assessment
 - Disaster recovery planning
- Pervasive management reporting & monitoring processes

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PERFORMANCE & RISK

- Risk is unavoidable in the organisational environment
- Increasingly, risk taking is necessary to achieve targets . . .
- . . . **but it must be managed**

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RISK MANAGEMENT FOR PERFORMANCE

- Focus on
 - what might happen (risks **and** opportunities)
 - ways of avoiding problems
 - ways of exploiting opportunities
 - part of strategic thinking

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ORGANISATIONAL RISK MANAGEMENT

- Risk assessment as the basis for strategy development, planning, operational activities, budgeting & resource allocation
- Objective for organisational RM ...
 - Part of day-to-day management
 - Not a 'one off' activity

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EXAMPLE: STRATEGIC RISKS & OPPORTUNITIES

- Merger of an established corporate with an established partnership
- New national activities & roles
- What is possible ?
 - New culture & relationships
 - New opportunities (& risks)

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EXAMPLE: ORGANISATIONAL RISK MANAGEMENT

- Risk plan
 - Integral to management philosophy
 - Aims to reduce risk & capture opportunities
 - Framework for measuring, reporting & controlling risks



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EXAMPLE continued

- Board committees
 - Audit
 - E, OH & S
 - Remuneration
- Corporate Governance & Legal Compliance Plan
- Monthly Board reports



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CORPORATE GOVERNANCE IN THE PUBLIC SECTOR

- Convergence with private sector
- Increased focus on performance
- Roles, accountability, ethics & probity
 - Ministers, Boards & management
- **Danger** -- Outsourcing in progress !

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ANAO ACTIVITIES

- Governance initiatives
 - Performance audits
 - Principles & Better Practice guides
 - Speeches & articles
- www.anao.gov.au



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STRATEGY REVIEW EXAMPLE

- Transport SA
- Executive review of the Strategic Management Plan
 - What are the risks to achievement of the plan?
 - What else should we be doing?



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RISK MANAGEMENT IS NOT RISK AVOIDANCE

- Commercial organisations make money by taking those risks they can manage well
- Avoiding all risks can be very expensive (& unprofitable)

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WHERE TO FROM HERE ?

- Corporate governance initiatives
 - Self-regulating, or ...
 - Regulatory & legislative
- Risk management development
 - Standards Australia handbook on risk & corporate governance

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RISK MANAGEMENT AND CORPORATE GOVERNANCE

- Distinguish between
 - Good & bad management
 - Good & bad luck
- Stop your hair & teeth falling out !
- **Learn to see in the dark !**

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